The Limits of Symbolic Reform

The New Deal and Taxation, 1933–1939

MARK H. LEFF
DEPARTMENT OF HISTORY
WASHINGTON UNIVERSITY

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Introduction: Political Imagery and Financial Reality

Anyone venturing onto terrain as forbidding as the tax system should have a good excuse. This book began innocently enough in Barry Karl's graduate seminar in 1972. Taxes were then – as always – in the news, particularly an ill-fated proposal by presidential candidate George McGovern to redistribute income, labeled by the *New York Times* "a return to the initial thrust of Franklin Roosevelt's New Deal."[1] This loose popular notion that New Deal taxes "aimed at far-reaching social reform" and income redistribution, thus reflecting the broader "social democratic emphasis" of the New Deal, was an enticing one.[2] Franklin Roosevelt himself, after all, had called for "a wiser, more equitable distribution of the national income" and had denounced the privileged few "economic royalists" whose "hatred" he tauntingly welcomed.[3] I did not then anticipate the parallels I would later find between the symbolic functions of New Deal rhetoric and the most celebrated New Deal tax bills, each a triumph of form over content. It was clear, though, that tax policy – characterized by one author as "at the heart of the New Deal"[4] – could offer a direct measure of the validity of this popular image of the New Deal.

Yet there was good reason to be skeptical of the image of the New Deal that Franklin Roosevelt helped to project. The emerging historical understanding of the New Deal, one that has elaborated and entrenched itself in the dozen years since I began this study, emphasized the New

1 *New York Times*, 2 July 1972, sec. 4, p. 8.

2 Forrest McDonald, *The United States in the Twentieth Century*, 2 (Reading, Mass.: Addison-Wesley, 1970), p. 116; W. Elliot Brownlee, *Dynamics of Ascent: A History of the American Economy* (New York: Knopf, 1974), p. 307; Hubert H. Humphrey, *The Political Philosophy of the New Deal* (Baton Rouge: Louisiana State University Press, 1970), p. 114.

3 Samuel I. Rosenman, comp., *The Public Papers and Addresses of Franklin D. Roosevelt*, 1 (New York: Random House, 1938): 645 (22 May 1932); Ibid., 5: 234 (27 June 1936); Ibid., 5: 568 (31 October 1936).

4 Oliver Pilat, *Pegler: Angry Man of the Press* (Boston: Beacon Press, 1963), p. 142.

Deal's commitment to the essentials of the capitalist system, called into question the degree of redistribution of power and wealth in the New Deal, and denigrated the feeble impact of the New Deal tax system. Ellis Hawley, for example, highlighted the New Deal's coupling of "skirmishes" on the economic "flanks" (such as attacks on "widely hated," "vulnerable" groups) with its willingness to underwrite piecemeal corporate efforts to attain economic stability.[5] Paul Conkin, too, had pointed to the Rooseveltian tendency to substitute fighting words and symbolic deeds for more substantive action.[6] Even so, I was not fully prepared for the statistical picture emerging from my research. By no stretch of the imagination was the New Deal tax system a vehicle for broad income redistribution to lift up those at the bottom of the economic pyramid. For various reasons, only some of them relating to the broader health of the economy, the share of tax collections drawn from potential sources of redistributive taxation (mainly the personal and corporate income taxes) was considerably *lower* in the New Deal than in World War I, the 1920s, or the decades succeeding the New Deal.

Gradually I came to recognize that two federal tax systems operated in the United States between 1933 and the eve of World War II: one a revenue workhorse, the other a symbolic showpiece. Though occasioning only nominal political debate, it was the first system, relying primarily on taxes that bore disproportionately on lower incomes, that counted financially. FDR not only inherited this skewed tax system; it was an edifice that he helped build and maintain. There was also a second tax structure, full of sound and fury over income taxes and loopholes. But it signified almost nothing in revenue terms, registering instead the waxing and waning of political status. These two themes – the transformation of the functional tax system and the political role of symbolic tax policy during the Roosevelt years – are the focus of this study.

This analysis, therefore, represents an exploration of the economic and political determinants of the New Deal tax system. Taxation has been characterized as an X-ray, revealing the anatomy of political and social power.[7] Yet the potential of this characterization has not been fully tapped,

5 Ellis W. Hawley, *The New Deal and the Problem of Monopoly* (Princeton, N.J.: Princeton University Press, 1966).

6 Paul K. Conkin, *FDR and the Origins of the Welfare State* (New York: Crowell, 1967). Conkin later developed this theme in Paul K. Conkin and David Burner, *A History of Recent America* (New York: Crowell, 1974), pp. 236–7, 243, 248.

7 William A. Williams, *The Great Evasion* (Chicago: Quadrangle Books, 1964), p. 159.

for the volatile mixture of politics and economics that shapes the tax structure tends to be neglected in favor of circumscribed studies that focus on either one or the other. It is the confluence of economics and politics (not such traditional economic approaches as the building of economic models to estimate the tax system's actual impact on economic growth) that concerns me in this study. To interpret taxation within the framework of the power alignments of the 1930s and of the New Deal as a whole, it is necessary continually to cross over this artificial boundary between politics and economics: to ask why trifling imposts produced more political heat than remunerative ones, to integrate the implicit and explicit economic theories generated by the Depression with the political assumptions of the period, to analyze the political forces that shaped taxation's distributive impact, and to evaluate the gap between private assessments and public pronouncements on tax policy. Ultimately, it is through such questions that the tactics of the New Deal and the operating assumptions of its tax system can most fully emerge.

In pursuing these questions, and particularly in understanding the broader political impact of tax controversies that in retrospect can seem much ado about nothing, I found valuable political scientist Murray Edelman's perspective on "symbolic politics." Edelman shows how political symbolism helps to create and maintain the gap between appearance and reality, between popular perceptions and "actual gains and losses" in power and money. The "choice or creation of political enemies," a tactic that proved so important in Roosevelt's presidency, is an integral part of this use of symbolism. The result, Edelman points out in an observation directly relevant to an understanding of the relationship of the New Deal to the reformist forces it confronted, can be to divert and reassure people and thereby to deflect or undermine reform efforts.[8]

To the extent that tax policy colors understanding of the New Deal, it can do so in misleading ways. In particular, Franklin Roosevelt's slashing oratory in the colorful 1935 Revenue Act fight can encourage the supposition that New Deal taxes must have eased income inequality in favor of the "forgotten man." Such conclusions are extravagant at best; high rates on upper income brackets were counterbalanced by less glamorous taxes that obtained more impressive collections from the poor. To this extent, the government acted as a bourgeois Robin Hood, taking not only from the rich but also at times from the poor to rescue the merely comfortable

8 Kenneth M. Dolbeare and Murray J. Edelman, *American Politics*, 3d ed. (Lexington, Mass.: Heath, 1977), pp. 471–2, 475, 456.

from the tax man. Given the influence of this "middle-class" group on tax debates (one evidenced in congressional solicitude for the lower- and middle-income tax brackets, the stable social center in which "your friends and my friends are found"),[9] this result is not unpredictable. William Buckley puts forward the generalization that since "the principal leverage in democratic bourgeois societies" belongs to the middle class, the upper and lower classes will bear a heavier share.[10] Yet this peculiar brand of redistribution, amounting to the successful playing of the middle against both ends, was not merely an indicator of middle-class influence. It was also not the sole creation of the New Deal. The income tax had been introduced in the spirit of a populist-progressive impulse that vilified "malefactors of great wealth." The carriers of this soak-the-rich tradition saw the nation as a battleground for two contending forces: a coterie of opulent power grabbers and the mass of "plain folks." Concentration of wealth and privilege affronted the partisans of this tradition, especially because they associated the acquisition of the great American fortunes with dishonest methods and practices. Tax policy, by cutting the bloated few down to size, would be emblematic of a shift in social and economic power, a shift that could restore fair play to the system. Since the late nineteenth century, this symbolic thrust had exercised special appeal to agrarian, cheap-money, antitrust forces. Thus the income tax was sponsored mainly by Southerners and Westerners as a means of limiting the excessive power of rich Easterners. Not until the pruning of income-tax exemptions in World War II (which, unlike the New Deal, was a watershed for the tax system) did this scourge of "abnormal" incomes become routine and financially productive. Despite a cut in income-tax exemptions and a rise in tax rates directed at the so-called middle class in the year preceding the New Deal, the income tax in the 1930s never applied to more than 5 percent of Americans, and only a small minority of those shouldered most of the tax. The renowned American suspicion of concentrated power and concern with opportunity fanned hostility to "special privilege," directing attention to the richest taxpayers. However, this scarcely represented a national commitment to income redistribution; in fact, it clashed with the powerful sentiment that government had no business divesting a solid citizen of his or her earned income to compensate for shortcomings of the weak or untalented.

9 U.S., Congress, House, *Congressional Record*, 73d Cong., 1st sess., 1933, pt. 5: 4359, 4347.

10 William F. Buckley, Jr., *Four Reforms: A Program for the '70s* (New York: Putnam, 1973), p. 60.

The income tax thus was designed more to quell abuses than to shift income within the rest of society – hence its heavy weighting toward the opulent. Taxation has always lacked a certain legitimacy in this country; the government's right to expropriate even a part of someone's reasonable living expenses was suspect. At least until World War II, the federal government could openly seek to tax only those who had a surplus of income that permitted them substantial savings (i.e., the rich, the super-rich, and corporations). Obviously, this structure of *direct* taxation had little capacity to tap the incomes of the American public as a whole; it was deliberately designed to *avoid* taxing "the people." Even in the twentieth century, the federal government has imposed major general tax hikes only in national emergencies: wars and the 1929–33 Crash.

This injunction against taxing the people, however, was not quite as constraining as it sounds. Its emphasis on taxing extraordinary wealth had an underside. *Indirect* taxation could be sanctioned as a lower-profile component of higher-visibility social or economic programs, or as an excise on nonessentials such as liquor or tobacco. These indirect taxes, which tended ultimately to fall most heavily on poorer consumers, injected regressive elements into the tax structure. The paramount triumph of the relatively affluent was in positioning themselves on the right side of the dividing line between plutocrat and average citizen, keeping their distance from the excesses of the super-rich. Though a higher corporate tax could reach middle-class stockholders, they otherwise enjoyed a double immunity. The symbolic progressive tax crusade against the economic royalists exempted them. Similarly, the resort to alternative tax rationalizations, finessing the ban on taxing the people, spawned regressive indirect taxes that treated their incomes kindly.

The result, according to the most detailed (though by no means authoritative) economic study of who ultimately ended up paying taxes in the 1930s, was that the federal tax burden applied at virtually a flat percentage rate to all except the most well-heeled 1 or 2 percent of Americans (with the poorest sixth also chipping in a little extra).[11] FDR's

11 Helen Tarasov, *Who Pays the Taxes?*, Temporary National Economic Committee Monograph No. 3 (Washington, D.C.: Government Printing Office, 1940), p. 6; Helen Tarasov, *Who Does Pay the Taxes?*, Studies in Government Finance (New York: New School for Social Research, 1942), p. 44. See also Mabel Newcomer, "Effect of the Tax Burden on Different Income Classes," in Carl Shoup et al., *Studies in Current Tax Problems* (New York: Twentieth Century Fund, 1937), pp. 29–30, 5. Thomas Renaghan's "Distributional Effects of Federal Tax Policy 1929–1939" (*Explorations in Economic History* 21 [January 1984]: 40–63) came to my attention after this book was in proofs. Renaghan's findings are largely consistent with the other studies cited here: starkly higher taxes on the

reputation for raising taxes on corporate profits, estates, and personal incomes is not undeserved (though Congress and other "outside" pressures merit much credit for these "New Deal accomplishments," but such taxes tended to concentrate on the largest incomes. Only the group at the very top of the income pyramid, the lucky 1 percent drawing over $10,000 a year, experienced a markedly bigger percentage tax bite. And, as seen in Part II, the disinclination to move beyond this top 1 percent sharply limited both the redistributive and the revenue potentials of the 1930s tax system.

The detailed analysis of fiscal decision making during the 1930s offered in succeeding chapters demonstrates that the New Deal response served to perpetuate previous attitudes and approaches to taxation, while creating a tax system whose effects often diverged from the rhetoric accompanying it. Indeed, the Roosevelt administration repeatedly extended the regressive excise taxes enacted under the Hoover administration, while adding to the burden on low-income Americans with taxes on liquor, agricultural commodities, and wages covered by social security. Other New Deal taxes would raise tax rates for corporations and the wealthy, but would not dig deeply enough into the income stream to have a significant impact on the income shares of the great majority of Americans.

This does not in itself demonstrate a New Deal failure to secure a fairer distribution of economic resources. That can only be assessed through a much broader study than this one, encompassing an analysis of the government programs that these taxes helped finance. That is an interesting question, to be sure, but it is also perilously complex and difficult to quantify (who, for example, received the financial benefit from government-backed mortgages: homeowners? banks? the construction in-

top 1% and some regressivity at the bottom of the income scale once social security taxes are included. He concludes that the greatest relative tax increases between 1929 and 1939 were in these top and bottom brackets. For the top 10% or so, Renaghan offers mixed results, showing some progressivity throughout for 1933 and 1936, only to have this progressivity vanish (for the percentiles below the very top) in 1939. I should note that certain methodological/technical problems affect Renaghan's findings, especially the hazards of combining estimated income levels of consumer units with the far more restrictive figures on net income registered in tax returns. Renaghan's method of supplying missing data, for example, seems to lead to a great exaggeration of the differences between the 1936 and 1939 tax distributions, since his resort to more prosperous 1941 figures as a proxy for the distribution of income in 1939 produces a distortion for the top brackets. Renaghan also offers a comparison of the "post-fiscal" impact on income (as measured by the changing Gini coefficient), but its applicability to this book seems limited by the inclusion of government transfer payments in addition to taxes.

dustry? construction workers?); besides, it is too encompassing and would have made it impossible to delve beneath the surface to examine the social and political implications of the highly controversial tax policy of the New Deal. One might similarly pursue the speculation that the New Deal's narrowly based income tax yielded such sparse revenues that it constrained the expansion of the welfare state, thus circumscribing the New Deal's redistributive potential. This, however, would have to be counterbalanced against the probability that a less popular and more "painful" tax policy – by promoting what conservatives called "tax consciousness" – would have broadened the base of resistance to New Deal expenditures.

Even the necessarily incomplete vista opened by this study is relevant to the broader question of the New Deal's impact. By assessing the level of awareness of tax incidence and the priority placed upon it, it brings into focus the New Deal's commitment to income redistribution. In addition, by locating New Deal taxes within their political context and by examining alternative tax proposals, it becomes easier to determine whether the New Deal took the nation to the border of reform possibility or whether it was more inclined to moderate or coopt movements for broader change. Were New Deal redistributive goals, in other words, articulated largely for public consumption, or did they represent a sincere operational commitment?

Chapter 1 addresses this question by establishing the framework for early New Deal nonprogressive taxes, whereas Chapter 2 analyzes the parallel tax-reform "soak-the-rich" effort, which until 1935 centered in Congress. But in 1935, the president shifted gears, a fundamental change in strategy analyzed in Chapter 3. The liberal swing in the 1934 elections, along with the famous "Thunder on the Left" from Huey Long and others, represented an increasing challenge to Roosevelt. His initial efforts to suppress this discontent and to salvage a middle way floundered as it became clear that recovery had helped revive intense business opposition. Roosevelt chose to stem the disintegration of his support by ceremoniously drumming the "overprivileged" out of his coalition. Rhetoric was the most direct way of dramatizing this rift and of binding together what was essentially a negative coalition. The quintessence of this strategy was its fearsome shadow, not its more limited substance. Thus the celebrated Revenue Act of 1935, though financially frivolous, was politically crucial to Roosevelt's broader strategy.

Chapter 4 traces the flowering of this approach toward taxation in 1936 and 1937, as FDR continued his sorties against "economic royalists." Yet, by the last years of the decade, the New Deal tax position received stinging setbacks. Part III chronicles this reversal, focusing particularly on the business ideology that played such an important role in setting the terms of the debate once the 1937 recession discredited New Deal economic leadership. Anxious to restore their tarnished status, businessmen targeted FDR's polarizing rhetoric and the tax legislation with which it had been associated. More substantive programs emerged unscathed, as the New Deal tax system drew hostile fire. Tax policy and the passions it evoked thus add a vital dimension to an understanding of Franklin Roosevelt's political appeal and the forces he confronted. Yet the tax structure itself exited the New Deal in much the same form it had entered it. The "forgotten man" – subject to a liquor tax, a social security tax, and renewed excise taxes – could derive only minimal concrete benefits from the new low-yield tax rates on upper-bracket incomes. The New Deal tax system illustrated the limits to symbolic reform.